



MULTISTATE TAX COMMISSION

**STATEMENT OF
JOAN WAGNON
CHAIR
MULTISTATE TAX COMMISSION
IN OPPOSITION TO
EXTENSION OF THE INTERNET ACCESS TAX MORATORIUM
BEFORE THE
COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION
MAY 23, 2007**

Mister Chairman, Ranking Member Stevens, and Members of the Committee on Commerce, Science and Transportation:

My name is Joan Wagnon and I am the Chair of the Multistate Tax Commission. I am also the Secretary of the Kansas Department of Revenue. The Multistate Tax Commission (MTC) is an intergovernmental State tax agency working on behalf of States and taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational enterprises. Created by the Multistate Tax Compact, the Commission is charged with:

- Facilitating the proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes;
- Promoting uniformity or compatibility in significant components of tax systems;

- Facilitating taxpayer convenience and compliance in the filing of tax returns and other phases of tax administration; and
- Avoiding duplicative taxation.

Established in 1967, forty-six States and the District of Columbia participate in the work of the MTC.

Thank you for the opportunity to present our views. In considering whether to enact a federal law that gives preferential treatment to one economic sector under State and local taxation, Congress must first consider its constitutional responsibility to allow state and local governments to manage their own fiscal affairs. It is axiomatic that States cannot provide governmental services to its citizenry without the power to raise revenues. Federal preemption of state taxing authority not only undercuts the States' ability to provide those services, it also undercuts the very life-blood of state power and distorts the Constitution's intentional balance of power between the federal government and the States that created it. Congress should, therefore, consider exercising its authority under the Commerce Clause of the United States Constitution to preempt State and local tax laws only when there is a compelling reason to do so.

Thus, it is appropriate to consider the reasons presented by the industry representative to see if they are of the magnitude to warrant federal preemption of State and local tax laws. The first argument is that "new taxes on Internet access could have a chilling effect on broadband investment." First, even if this were true, it provides no basis for Congressional regulation under the Commerce Clause. Second, it may not even be true. The best way of testing the validity of this statement is to examine the evidence in the nine States that currently impose taxes on Internet access and compare that

evidence to that of the other forty-one States. In fact, this very analysis was performed by economists at the University of Tennessee who conducted a regression study to discern whether there was any impact of existing Internet access taxes on Internet access. The result: “Internet access taxation has no statistically discernible effect.” (*State Tax Notes*, May 17, 2004, p 519). The industry representative did not provide any evidence to the contrary.

The second argument advanced in support of federally-imposed preferential tax treatment is that “new taxes on Internet access would create a new obstacle in efforts to close the ‘digital divide.’” In other words, a monthly tax of 4 ½ percent to 7 ½ percent of a thirty dollar access fee (\$1.35 - \$2.25 per month) would discourage those of limited means from accessing the Internet. Once again, no evidence was presented to back up this assertion. A larger obstacle preventing Internet access would be the cost of the computer itself. Moreover, American consumers pay ten times or more for Internet access than do their fellow consumers across the globe. (Testimony of Ben Scott, Consumer Federation of America before the US Senate Committee on Commerce, Science and Transportation, “Communications, Broadband and Competitiveness: How Does the U.S. Measure Up?”, April 24, 2007) Therein lies the “digital divide.”

Finally, the proponents of imposing permanent preferential tax treatment of one industry upon state and local governments argue that Internet access taxes are discriminatory, imposing a higher taxation burden on Internet users than on non-Internet users. Once again, no evidence is presented from the nine existing States that already tax Internet access. There is only a comparison to the telecommunications industry, which is still adjusting from decades of monopoly status to its current competitive situation.

Ironically, however, it is the current Internet access tax moratorium that causes discriminatory taxation. Under the present moratorium, non-grandfathered States may not tax e-mails or instant messaging. Yet, text messaging does not fall within the moratorium and is taxed under existing State and local telecommunication tax laws. The current moratorium, therefore, causes discriminatory tax treatment of functionally equivalent digital communications methods. Indeed, the moratorium results in disparate tax treatment if electronic messages accessed on precisely the same digital device; e-mails and instant messaging accessed on a cell phone come within the moratorium while text messages accessed on the same cell phone do not.

The proponents of a permanent Internet access tax preemption have not provided any substantive justification for Congressional exercise of interstate commerce authority for this one sector of the national economy. Congress has traditionally seen fit to intervene in State and local tax policy choices only where there has been a perception that states may seek to “export” their tax burdens or where taxation would impose a disproportionate burden on interstate business. Thus, when Congress passed the Railroad Revitalization and Recovery Act of 1977, it chose to prohibit State taxation only to the extent such taxes discriminated or imposed higher burdens on railroads than competing modes of transportation. (*See also*, Buck Act – prohibiting States from imposing discriminatory income taxes on federal employees on federal reservation; Airline Workers Act – limiting taxation of airline employees to state of residence or state where 50% of flight time occurs; State Retirement Act – limiting state taxation of pension income to residents.) The common thread in each of these acts has been to trust local legislatures to respond to political pressure brought by its constituents. Where a tax is

passed on to local consumers, as is the case with internet access charges, the political process ensures that those taxes will remain at an appropriate level.

Moreover, it is worth reconsidering the original purpose for the 1998 federal preemption and whether that legislative purpose is still valid in 2007. When President Clinton signed the original law nine years ago, Internet access was considered a “fledgling” industry. In 2007, it is “fledgling” no more. In the last six years, e-commerce has ballooned from \$25.8 billion to \$107.8 billion, and high-speed lines have expanded from 9 million locations to nearly 65 million. Looking into the future, Internet Protocol Television is expected to expand by 92 percent per year. Any justification that existed nine years ago to aid this sector of the economy by bestowing upon it federal preferential treatment under State and local tax laws, therefore, no longer exists today.

Thank you again for the opportunity to present these views.